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CIRCULAR
February 6, 2007

NEW PROCEDURE FOR THE EXECUTION OF EXCHANGE FOR PHYSICAL (EFP) TRANSACTIONS

Bourse de Montréal Inc. (the Bourse) wishes to inform all approved participants that in order to formalize its existing practices and operational procedures relating to exchange for physical transactions (EFP) and to standardize the reporting of this type of transaction by approved participants, the Bourse will be implementing the attached procedure and reporting form applicable to the execution of EFP transactions on February 12, 2007.

The purpose of this procedure is to improve and clarify existing operational practices currently applied for the execution of EFP transactions. The procedure covers in detail the following topics:

- Pricing of an EFP transaction;
- Conditions that must be satisfied in order to have the EFP transaction approved by the Bourse;
- Acceptable cash components;
- Reporting of EFP transactions to the Bourse; and
- Audit trail requirements.

In addition to this procedure, the Bourse has also revised its EFP reporting form and the manner in which this report must be filed with the Bourse. The revised EFP reporting form will now be accessible on the Bourse's website and shall be transmitted, once completed, from that location to the Market Monitoring Department of the Bourse for approval of the transaction. In the course of the transmission of this report to the Bourse, a copy of it will be automatically forwarded to the Regulatory Division of the Bourse for review and analysis to ensure that the transaction is in full compliance with the requirements of article 6815 of the Rules of the Bourse and with the attached procedure.

With these changes, approved participants will now be provided with an easy access to a standardized EFP reporting form that will permit to standardize the information being communicated to the Bourse regarding EFP transactions.

Attached to this circular are a copy of the procedure and a specimen copy of the EFP reporting form. The EFP reporting form is available on the Bourse's website through the following quick link: http://www.m-x.ca/efp_formulaire_en.php.

Circular no.: 021-2007

The Bourse's operational procedures may be modified from time-to-time in order to take into account the evolution of the trading environment and operational practices or regulatory amendments. Approved participants will be advised by a Bourse's circular each time such modifications to existing procedures have to be made.

For additional information, please communicate with Richard Bourbonnière, Vice-President - Market Operations, at (514) 871-3548 or by e-mail at rbourbonniere@m-x.ca.

Joëlle Saint-Arnault
Vice-President, Legal Affairs and Secretary



PROCEDURE FOR THE EXECUTION AND REPORTING OF EXCHANGE FOR PHYSICAL (EFP) TRANSACTIONS

The purpose of the following procedure is to explain as fully as possible the requirements of article 6815 of the Rules of Bourse de Montréal Inc. (the Bourse) relating to the execution of transactions involving the exchange of futures contracts for a corresponding cash position (Exchange for Physical (EFP) transactions). Approved participants must ensure that all of their employees who are involved in the execution of this type of transactions are fully aware of this procedure. Any violation of the requirements set forth in article 6815 of the Rules of the Bourse and in this procedure could result in disciplinary action being taken by the Bourse.

Exchanges for Physicals (EFP)

An EFP is a transaction whereby two parties enter into an agreement in which one party purchases a cash market position and simultaneously sells a corresponding futures contracts position and the other party sells the cash market position and simultaneously purchases the corresponding futures contract position.

The Bourse permits EFP transactions on the following futures contracts: Ten-Year Government of Canada Bond futures contracts (CGB), Two-Year Government of Canada Bond futures contracts (CGZ), S&P Canada 60 Index futures contracts (SXF) and sectorial index futures contracts (SXA, SXB, SXH and SXY).

Pricing the Cash component of an EFP

The cash component of an EFP is priced at such level that is mutually agreed upon by the two parties to the transaction.

The futures contract leg of an EFP transacted between two different approved participants must be priced within the high and low prices of the trading session during which the EFP is deemed to have been reported to the Bourse.

The cash component of an EFP transaction must be the futures contract underlying interest, a by-product of this underlying interest or a similar product that is reasonably correlated to the futures contract being exchanged. Approved participants who are parties to an EFP transaction may be required to demonstrate that the cash market component and the futures contract position are sufficiently correlated to make the transaction acceptable to the Bourse.

Also, the number of the futures contracts exchanged must be approximately equivalent to the underlying quantity of the related cash market position being exchanged. Approved participants that are parties to an EFP transaction may be required to demonstrate such equivalency.

Acceptable EFP Transactions

In order to have an EFP transaction accepted by the Bourse, the transaction must satisfy the following conditions:

- There must be separate but integrally related cash and futures contracts transactions.
- The transaction must be done between two separate accounts that must satisfy at least one of the following criteria:
 - accounts have different beneficial ownership;
 - accounts have the same beneficial ownership but are under separate control; or
 - accounts are under a common control but involve separate legal entities which may or may not have the same beneficial ownership.

If the parties to an EFP transaction involve the same legal entity, same beneficial owner or separate legal entities under common control, the approved participant (or the parties themselves) must be able to demonstrate that the EFP transaction is a legitimate arm's length transaction.

- The cash market instrument leg of the EFP transaction must provide for a transfer of ownership of the cash market instrument to the buyer of this instrument and the delivery of this instrument must take place within a reasonable period of time (in accordance with cash market practice).
- The relation between the prices of the futures contract and of the cash instrument legs of the EFP transaction and the relevant prices in either market must be established.
- If he does not have actual possession of the cash instrument before the execution of the EFP transaction, the cash instrument seller must be able to demonstrate his ability to satisfy his delivery obligation.

Acceptable Cash Components for the purpose of an EFP Transaction

In order to have an EFP transaction accepted by the Bourse, the cash component of the transaction must satisfy the following conditions:

- **For interest rates futures contracts (CGB and CGZ):** all maturities of Government of Canada fixed income bonds that are reasonably correlated to the futures contract being exchanged. Approved participants involved in an EFP transaction may be required to demonstrate that the related cash bond position and the futures contract position are reasonably correlated.

- **For stock index futures contracts (SXF and sectorial indexes):** stock baskets must be highly correlated to the underlying index with a correlation coefficient (R^2) of 0.90 or more. Furthermore, these stock baskets must represent a weight of at least 50% of the underlying index or must include at least 50% of the securities of the underlying index. The notional value of the basket must be fairly equal to the value of the futures contract component of the trade. Exchange Traded Funds (iShares) are also acceptable, provided they mirror the index futures contract against which the EFP transaction is made.

Reporting an EFP transaction to the Bourse

EFP transactions must be reported to the Bourse's Market Monitoring Department for approval and subsequent input into the Montréal Automated System (SAM). Approved participants for both the seller and buyer must complete and submit to the Market Monitoring Department the EFP reporting form prescribed by the Bourse. This form is available on the website of the Bourse at http://www.m-x.ca/efp_formulaire_en.php. If the EFP transaction is executed before the closing of the trading session of the futures contract involved in the transaction, the EFP reporting form must be submitted immediately upon the execution of the transaction. If the EFP transaction is made after the closing of the trading session, the EFP reporting form must be submitted no later than 10:00 a.m. on the next trading day.

If the EFP reporting form is not accurately filled out with all the relevant information required by the Market Monitoring Department of the Bourse, the transaction will not be approved neither recorded in SAM and the approved participant will have to resubmit a new EFP reporting form correctly completed.

Once correctly completed EFP reporting forms have been received, the Market Monitoring Department will validate the transaction. The Bourse has the discretion to refuse an EFP transaction if it deems that it is not in compliance with the requirements of article 6815 of the Rules of the Bourse or of this procedure. In case of refusal, the Market Monitoring Department will ensure that the approved participant(s) involved in the EFP transaction will be promptly informed of such refusal and of the reasons for it.

Once an EFP transaction has been validated and has been entered into SAM by the Market Monitoring Department, the following information with respect to the EFP transaction will be disseminated by the Bourse on its website at http://www.m-x.ca/dailycrosses_en.php.

- Date and product description (code);
- Contract month(s); and
- Volume of each contract month.

Trade validation and market dissemination by the Bourse of an EFP transaction will not preclude the Bourse from initiating any investigation and, as the case may be, disciplinary procedures in the event that the transaction is subsequently found to have been made other than in accordance with the requirements of article 6815 of the Rules of the Bourse or of this procedure.

Audit Trails Requirements for EFP Transactions

Approved participants who enter into an EFP transaction must maintain all documents relevant to the futures contracts and corresponding cash market position transactions, and must be able to promptly provide copies of such documents to the Regulatory Division of the Bourse upon request. Documents that may be requested include, but are not limited to, the following:

- Futures contracts order tickets;
- Futures contracts account statements;
- Documentation customarily generated in accordance with cash market or other relevant market practices such as cash account statements, trade confirmations statements or other documents of title;
- Third party documentation to support proof of payment or allowing to verify that the ownership title of the related cash market position was transferred from the seller to the buyer. This may include, but is not limited to canceled checks, bank statements; cash account statements and cash instruments clearing corporation documents (e.g.: Canadian Depository for Securities – CDS).

All futures contracts order tickets must clearly indicate the time of execution of the EFP transactions.

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